Doing Well by Doing Good – Impact Investing as a Mainstream Investment Philosophy

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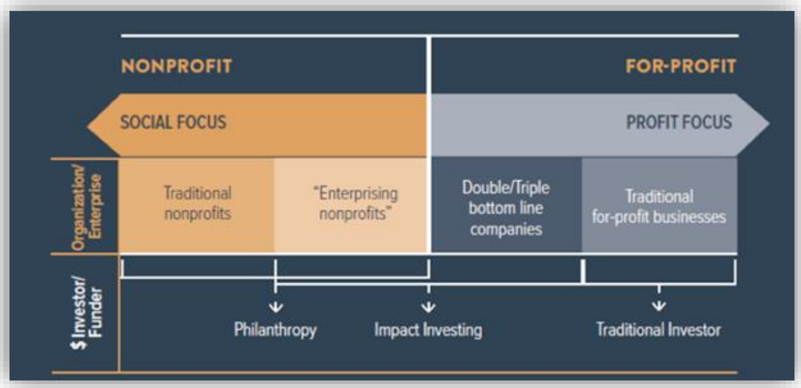
Impact Investing may be the most meaningful directional shift in asset management that you've not considered, an investment methodology simmering below the surface and about to broaden and go mainstream with the near-term seismic generational transfer of wealth. Impact Investments seek a return *of* capital, a market return *on* capital and a social/societal return[1] on the capital invested. *Doing well by doing good* isn't simply a platitude. It can be very real. Lives can change for the better by virtue of your investment, without sacrificing returns.

Returns, Philanthropy and Mental Accounting

I teach an investment class as a Special Lecturer at *Yale School of Management*. A few weeks back, I did one of my favorite classes, "Human Biases and Investing." There is a particular bias – *mental accounting* – that I believe is at the heart of investor's historic reticence to allocate to impact investments. As humans, given a "mental accounting bias," we are prone to intellectually create different "accounts" for money based on source or purpose. A good example is the gambler that wins some money, tucks away their original betting capital to play with just the winnings, or "house money" as its "free." Money is money, no? Well to date, and perhaps generationally, individuals and institutions have created separate buckets of capital, one earmarked to earn market-based returns and the other, to be given away to drive philanthropic goals. The twain never to meet. Why?

Impact Investing seeks to generate a positive social or environmental impact alongside a financial return. This investing philosophy spans asset classes, geographies and societal initiatives. Whether investing venture capital in an application that provides educational material for under-resourced schools, funding a social impact bond that aims to reduce recidivism among juvenile offenders, or buying tranches of bundled critical equipment loans, financing a burgeoning work populace in continental Africa, this approach seeks profit-making commercial solutions to social and/or environmental challenges.



Source: Case Foundation

Impact Investing's cash (and social) returns have been good, proving that *you can do well by doing good*. As Impact Investing done well, returns all invested capital back to the investor, allocations to Impact Investments are *revolving*, that is, as money is returned to the investor, it can be put back to work in a new investment. As for many, this blurs the line between philanthropy and investment; philanthropy will come to be defined in a narrower and different way. So too, will Impact Investing – it will become mainstream as an investment philosophy.

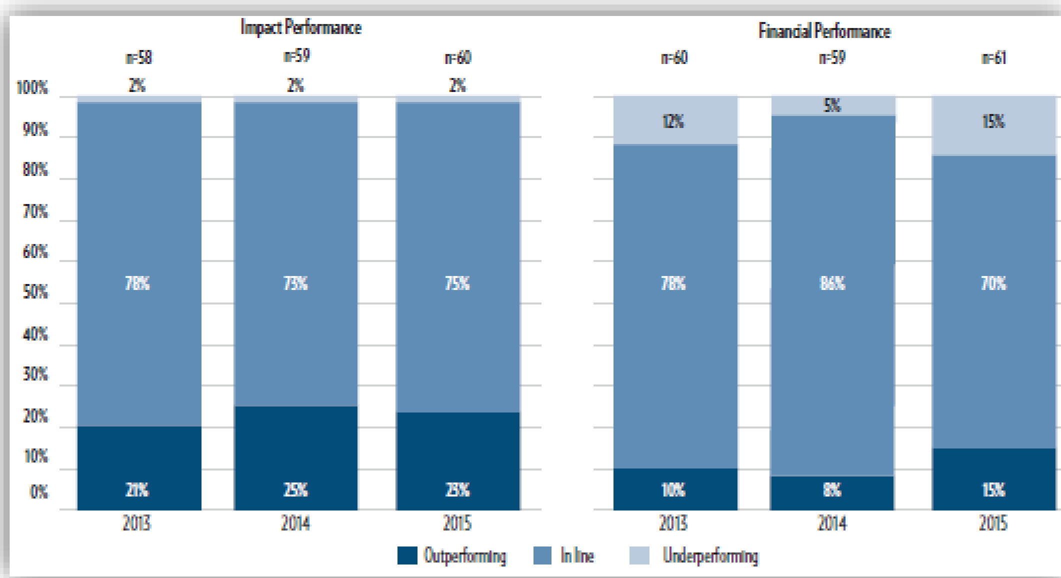
[1] There has been, and continues to be much work done regarding quantifying a social return. See: https://iris.thegiin.org

Impact Investor Gross Return Expectations

	Debt	Equity
n	15	16
2013	6.5%	19.1%
2014	5.5%	18.3%
2015	5.2%	17.6%

Source: GIIN

Impact Investments Predominantly Meet or Exceed Gross Return Expectations



Source: GIIN

Impact Investing – An Approach Hiding in Plain Sight

While many consider Impact Investing obscure, it is by no means new, invisible or well, tiny and not impactful. Investors plan to commit $25.9bn in assets to Impact Investing in 2017, according to a survey by GIIN, the *Global Impact Investing Network*.[2] In 2016, participants committed a total $22.1 billion across 7,951 impact investment deals. Surveyed participants said they planned to commit a total of $17.7 billion in 2016 across 11,722 deals.[3]

Impact Investing is on the ascent, and what is exciting, is that it feels and appears that Impact Investing is poised to take off, largely a function of what will be the single largest generational transfer of wealth.

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[2] *Annual Impact Investor Survey – 2017*, Global Impact Investing Network
[3] IBID

Impact Investing as a Mainstream Investment Philosophy – Driven by the Seismic Generational Transfer of Wealth

Millennials have now surpassed Baby Boomers as the nation's largest demographic segment. Millennials are demanding more integration of their money and values by seeking personal fulfillment in their careers, applying a global consciousness to their purchases and investing in sustainable, impactful business models. According to a *US Trust* 2017 study, 76% of Millennials said they consider their investment decisions to be a way to express their social, political and environmental values, and 88% said that a company's impact in these areas is an important consideration when they make investment decisions.[4]

At more than 83 million strong and comprising nearly one-third of the US population, those born between 1980 and 2004 are redefining society in profound ways. And with more than $30 trillion passing to them through inheritance over the next 30 years,[5] Millennial investors will use their wealth to reshape not just markets, but the world.

This, the largest generational transfer of wealth, is expected to peak between 2031 and 2045, during which 10% of total wealth in the US will be changing hands every 5 years. Further, women will control approximately 70% of this wealth by 2031.[6]

Impact Investing – Fallacies, Misconceptions and Biases

Impact Investing is not without its naysayers, largely a function of a lack of familiarity and, well, mental accounting. To many, it is a relatively new segment within the financial industry. As such it is subject to misconceptions that can dampen its growth and are worth dispelling.

Portfolio profits and impact are mutually exclusive – As discussed, some individuals and institutions "mentally account" for their capital in two distinct buckets: one dedicated to returns and one to philanthropy, the former subsidizing the latter. Impact Investing offers an investment approach, which seeks to deliver both desirable returns *and* a defined social impact, negating the binary "make impact or make profit" mentality.

Impact Investing is philanthropy - Impact Investing is investing with an inherent expectation of financial return. It is not giving money away to solve social or environmental problems. It is neither philanthropy, nor based on grant making. It is also not dedicated to funding public sector projects. However, it can cater to different risk-return

[4] *US Trust Insights on Wealth and Worth – The Generational Collide*, 2017
[5] Accenture Consulting
[6] IBID

preferences within the same structure and draw investors from both the public and private sectors (blended finance) to catalyze innovation.

Impact Investing implies financial sacrifices - Impact Investing need not entail sacrificing financial returns for social or environmental benefits. A range of expected financial returns, from market-rate to concessionary, can be achieved depending on the particular investment and predicated on the investors' requirements.

High returns imply low impact - Higher financial returns need not have a negative effect on the quality of the impact investment. A 2011 study by *Grabenwarter and Liechtenstein* found that it cannot be implied that financial returns are inversely correlated with impact generation.[7] Conversely, it is often argued that more sustainable business models generating more goods or services positively benefiting a growing set of clients will outperform, implying a positive correlation between the social/environmental impact and financial returns. While indeed compelling, there is not yet statistically relevant data to fully substantiate this claim.

Impact Investing is only in poor countries - While poverty is more glaring in, say, rural Sub-Saharan Africa than in Western Europe, developed countries also have challenges that Impact Investing can address. For example, the financial crisis resulted in high rates of youth unemployment in parts of Europe, cut off capital to small businesses in all developed markets, and reduced investing in critical infrastructure. There are also significant environmental challenges in developed markets around the world. These problems are often less visible than contaminated water supplies in India or slum dwellings in Brazil, but Impact Investing can focus on any social or environmental problem/market efficiency regardless of geography.

Impact Investing – A Mainstream Investment Philosophy

By allocating investible capital toward products, services and companies that generate positive social impact, the movement toward Impact Investing has the potential to create tangible value both for investors and for society.

The quest for opportunities that allow investors to *do well while doing good* is not a pipe dream. A growing interest in Impact Investing has spurred the development of a new field that is evolving toward integration into the mainstream of investment strategies. The funding of innovative and forward-looking business models is increasingly being facilitated by new financial structures developed to enable a triple bottom line[8] with results for people, planet, and profit.

We appear to be at the beginning of an opportune time for Impact Investing, as more private investors seek to make meaningful differences alongside profit in their portfolios, and public sectors increasingly seek to plug funding gaps for crucial social, environmental and development problems. As the industry matures, we believe that investors will have a plethora of innovative and effective options to make a difference in an increasingly satisfying and fulfilling manner. Further, that professional investment management will move in this direction, influencing the skills required and jobs to fill, to participate in advising and managing the magnitude of capital soon to be driven by the socially conscious investing preferences of the youthful inheritors of the largest generational transfer of wealth.

[7] *In Search for Gamma, an Unconventional Perspective on Impact Investing*, IESE, Grabenwarter and Liechtenstein, 2011

[8] *Triple Bottom Line*, or what is sometimes called the "Three P's" (Profit, People and Planet), was coined in 1994 by John Elkington, the founder of British consultancy, SustainAbility. It aims to measure the financial, social and environmental performance of the corporation over a period. Some argue that these measurements account for the full/true cost involved in doing business.

About the Author and Lupoff Friends and Family Interests:

Lupoff Friends and Family Interests LLC is the holding company of the various activities, including investments, academic and philanthropic work, consultation, projects and other varied initiatives of Peter M. Lupoff and Family. Lupoff Friends and Family Interests LLC is a Family Office making direct investments on behalf of the Lupoff Family and Friends in public securities through its own and managed accounts, outside managers, as well as Impact Investments (direct investment and consultative).

Lupoff Friends and Family have three strategies: *Lupoff Concentrate* (Concentrated Best Ideas), *Lupoff Tactical* (Tactical ETF Strategy), *Lupoff Income* (High Income Equities “Social Contract” Screen). Contact for more information. Further, Lupoff Friends and Family provide source, due diligence and allocation advisory to Friends and Family, related to Impact Investments and third-party investment manager allocations.

Peter conceived of, and operates various Tiburon Extern Research Project ("TERP") programs, presently offered exclusively via The Yale School of Management. A Fellow at think tank, World Policy Institute, Mr. Lupoff continues and expands his work on Markets, Behavioral Finance, Impact Investing, Market Shock and Dislocation. Peter is also President of Clean Power for Humanity, a not-for-profit with the objective of bringing green power to rural developing world communities, to expand education and commerce.

In 2009, Lupoff founded registered investment advisor, Tiburon Capital Management, an event-driven fund manager. Peter was Chief Investment Officer and Portfolio Manager of Tiburon 2009-2017. Peter remains an advisor to Tiburon. Peter was formerly a Managing Director at Israel Englander’s Millennium Management, where he managed an event-driven allocation the Millennium Partners flagship fund. Peter’s risk management and markets sensibility is largely informed by this experience.

Mr. Lupoff’s experience in deep value equity and distressed investing strategies began in 1990 when he began working with Marty Whitman of Third Avenue Funds. Peter’s deep value, bottom-up approach is largely informed by this experience.

Mr. Lupoff is a regular featured discussant on academic papers related to, and consultant to, The Federal Reserve Bank regarding market shocks and liquidity. Mr. Lupoff is an outside director of various unaffiliated investment entity and consults hedge funds and other institutional asset managers regarding business development, conflicts and liquidity and liquidation execution. Peter also provides expert litigation testimony on matters related to hedge funds, trading and his specific strategies.